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SUBJECT: SCENESSETTER FOR VISIT OF DAS QUANRUD, NOVEMBER 30
- DECEMBER 2

Classified By: Ambassador Judith Garber, reasons 1.4 (b) and (d)

11. (C) Summary: In a time of severe economic crisis and political uncertainty, we remain focused on keeping Latvia actively engaged as a contributing member of the Trans-Atlantic community. Your visit will enable us to underscore and reinforce our key messages: emphasizing the strategic importance of Latvia's engagement in NATO; encouraging the structural reforms and transparency needed for sustainable future economic growth and foreign investment; and advancing the protection of human rights, particularly with regard to victims of trafficking in persons and Jewish property restitution.

The Economic Scene

12. (C) Over the past two years, Latvia's economy has lost more than a fifth of its value, with an 18.4% drop this year alone. While the free-fall appears to have bottomed out and a slow recovery is on the horizon, the collapse of the revenue base has required massive budget cuts, and unwelcome tax hikes in an anti-tax political culture. Your visit coincides with the second and final reading of the Latvian budget in Parliament on December 1. While the IMF and the Government of Latvia have reached an agreement on the structure of an income tax rise, a \$120 million disagreement remains over the introduction of a property tax. The IMF privately has described this gap as "closable", and it is expected that the budget will be passed and the IMF and EU loan support will continue, but tension and uncertainty remain. The pain of severe social service budget cuts has not yet been fully felt, and discontent will rise as national elections approach in October 2010. Meeting the Maastricht criteria for euro accession by 2014 is looking more unlikely by the month.

13. (C) The economic crisis presents Latvia with an opportunity to streamline a bloated bureaucracy, restructure, and attract investment with lower wages. But the across-the-board cuts applied so far lack strategic vision. Moreover, there is a widespread perception that corruption is becoming more pervasive, exemplified in the dramatic drop of half a point in Transparency International's rating for Latvia. This perception could inhibit foreign investment. Brave voices like Latvian Chamber of Commerce Chair Zaneta Jaunzeme-Grende need our support as they seek to expose and combat corruption. Here, we are approaching the problem of corruption not as an exercise in morals, but in empirical practicality -- with the message the more corruption there is, the more difficult it will be to emerge from the economic crisis. As the 8th largest investor in Latvia, with nearly \$500 million of direct investment in 2008, our voice matters. You should deliver a "tough love" message on the importance of meeting international commitments and pushing ahead with structural reforms, approaching elections notwithstanding.

The Political Scene

14. (C) Within the governing coalition, a grouping of three centrist parties (New Era, Civic Union, and Society for Alternative Politics) is now coalescing under the banner "Unity," while two other parties (People's Party and the Union of Greens and Farmers) serve the fortunes of their own respective wealthy and populist leaders, Andris Skele and Aivars Lembergs. In opposition, another populist and dynamic "oligarch," Ainars Slesers, has allied his Latvia's First Party/Latvia's Way with the largely ethnic-Russian Harmony Center coalition, taking control of Riga City Council in local elections this past June. Although national elections are eleven months away, the jockeying and posturing has begun, with every party seeking to maintain at least the 5% threshold needed to secure Parliamentary representation.

NATO

15. (C) While supportive of our "reset" efforts with Russia, the GOL remains wary of Moscow's intentions. The recent ZAPAD war games chilled the Latvians, and while our missile defense decision was publicly received well, there remains uncertainty about NATO's commitment to Latvian security in private conversations even among senior officials. The Latvian government does not want public discussion of "contingency planning," but it does want NATO to undertake such plans for the defense of the Baltic states. Your interlocutors here at the MOD and MFA will probe to learn the status of our decisionmaking on the "contingency planning" issue. The Latvians are currently pleased with the level and nature of our exercise and training schedule here, and want these activities to continue. They are also in lockstep with

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our NATO expansion policies in Georgia, Ukraine and the Western Balkans. While Latvia can no longer afford overseas assistance programs, the GoL still promotes democratic reform in these countries, as well as in Belarus and Moldova.

16. (C) The Latvians were forced to cut their defense budget to \$275 million in FY2010, still over one percent of GDP, and enough to maintain Latvia's commitment of 175 troops in Afghanistan, but too low a level to sustain Latvia's military capabilities in the long term. Latvian deployments in Afghanistan regularly receive the support of nearly two thirds of parliament, with criticism largely limited to ethnic Russian politicians. Latvian participation in the Northern Distribution Network of logistic supply for Afghanistan is widely welcomed, although hoped for contracts for locally-procured supplies have yet to materialize.

Energy

17. (C) Latvia has utilized hydropower for a third of its electricity needs, but advances and investments in biomass and wind, as well as a trans-Baltic Sea electrical grid will be needed to diversify and obtain greater energy independence. The impending December 31 closure of the Ignalina nuclear power plant in Lithuania will lead to greater dependence on Russian electricity for Latvia and its neighbors in the Baltic "energy island." The replacement Visaginas nuclear plant is still at least a decade away, but Latvia, Estonia and Lithuania can act to reduce barriers to electric market cooperation now. Latvia should act on the recommendations of the Baltic Energy Market Interconnection Plan. Latvia's vast geologic storage formations enable it to maintain a reserve of two years worth of gas, but it remains dependent on Russia for gas supply. Latvia may build a coal-fired power plant by 2015 to lessen its dependence on gas.

Human Rights: Trafficking and Property Restitution

18. (C) The economic crisis has severely hindered the capacity

of the GOL to prevent trafficking, protect victims, and prosecute criminals. While the GoL has demonstrated some political will to sustain its efforts, the economic crisis will certainly create more opportunities for traffickers. We must continue to make the case that fighting trafficking is more, not less of a priority in a time of crisis. Likewise, there is little political will to move from task force study to political action on returning communal and heirless property taken during the Holocaust back to the Jewish Community. Many of these properties are lying unused, vacant and decaying, and their immediate return would not cost the Latvian taxpayer or state. The return of other properties may require additional time and resources, but the framework for return of all property should be established, and the Jewish community should be consulted by the GOL as an inherent part of that process.

GARBER